Sharing (Gig) Economy

September 7, 2017

Highlights

- Tax Consequences of Payments Received through Sharing Economy
- Employment Status of Sharing Economy Workers
- State Nexus and Apportionment Issues Triggered by Sharing Economy
- Types of Expenses Deducted by Sharing Economy Workers

Inside

SPECIAL REPORT

Federal and State Tax Impacts of the Sharing (Gig) Economy

The sharing, or gig, economy allows individuals and groups to use technology advancements to arrange transactions that generate revenue from their assets, such as cars and homes, or from services they provide, such as household chores, delivery, or technology services. The internet is used to connect suppliers to consumers. The sharing (gig) economy is often used to connect workers and businesses for short-term work. Income received is generally taxable, even if the recipient does not receive a federal Form 1099, W-2, or some other income statement. Depending upon the circumstances, some or all business expenses may be deductible.

INCOME RECOGNITION

Federal gross income includes compensation for services realized in any form. It encompasses nearly every type of increase in wealth that is not specifically excluded. So, individuals who participate in the sharing (gig) economy and who receive compensation in return for the goods or services they provide receive gross income in the amount of that compensation. Persons who are paid for their services with property or stock, or who exchange their services for the services of another, must generally treat the value of the property or services received as income. Compensation for services includes not only common items like wages and salaries, but also vacation allowances, bonuses, commissions, tips, fringe benefits, severance pay, rewards, and other similar items.

> **STATE TAX IMPACT.** *Generally, states use federal gross income, federal adjusted gross income (AGI), or federal taxable income as the starting point to calculate the base upon which state personal income tax is imposed. As a result, income earned in the sharing (gig) economy that is taxable for federal income tax purposes is typically taxable for state income tax purposes as well.*

EMPLOYEE VS. INDEPENDENT CONTRACTOR

An individual sharing (gig) economy worker is typically going to be treated as an independent contractor for federal tax purposes. Because a business does not have federal employment tax obligations on compensation it pays to independent contractors for their services, it is important that the business distinguish its employees from its independent contractors.

- Employee — an individual is an employee if the service recipient for whom the individual performs the services has the right to control what work will be done and how it will be done.
- Independent Contractor — an individual is an independent contractor if the service recipient for whom the individual performs the services has the right to control or direct merely the result of the work, but not the means and methods of accomplishing the result.

An individual sharing (gig) economy worker is typically going to be treated as an independent contractor for federal tax purposes.

STATE TAX IMPACT. *State tax nexus and apportionment issues can be triggered by a business's use of independent contractors. For example, under the federal Interstate Income Tax Law (P.L. 86-272), an out-of-state business is not subject to taxation by a state merely because independent contractors are making sales, soliciting sales, or maintaining an office in the state on behalf of the business. On the other hand, other activities by an independent contractor in a state may create nexus for an out-of-state business hiring the independent contractor, such as an independent contractor maintaining a stock of goods in the state under consignment or any other type of arrangement with the business (other than for purposes of display or solicitation).*

The use of independent contractors can also have consequences for the apportionment of a multistate corporation's income. For instance, some states using the income producing activity/costs of performance method for sourcing sales of other than tangible personal property specifically include or exclude services performed by an independent contractor in determining a corporation's sales factor. A few other states use a set of cascading sourcing rules to determine whether services performed on behalf of a corporation by an independent contractor are sourced to the state. In addition, for purposes of determining a corporation's payroll factor, payments to independent contractors are typically excluded.

FILING/PAYMENT REQUIREMENTS

If an individual sharing (gig) economy worker is properly classified as an independent contractor and not as an employee of the person to whom the individual provides services, the service recipient is not required to withhold federal income and employment taxes from the individual's compensation for the services. However, the individual worker is still responsible for properly reporting and paying to the IRS sharing economy income. This is true even if the individual provides the service as a side job or part-time business, and even if he or she is paid in cash. To meet the federal tax obligation, the individual worker might be required to report and pay self-employment tax, and may need to make estimated tax payments, in addition to the "normal" filing of an annual federal income tax return.

Estimated Payments

A person or business that receives sharing (gig) economy services is usually not required to withhold any federal taxes from the payments it makes to the individual worker for those services. Because the federal income tax system is a "pay as you go" system, however, the individual worker may need to pay estimated tax on sharing economy income over the course of the tax year, or possibly face an underpayment penalty.

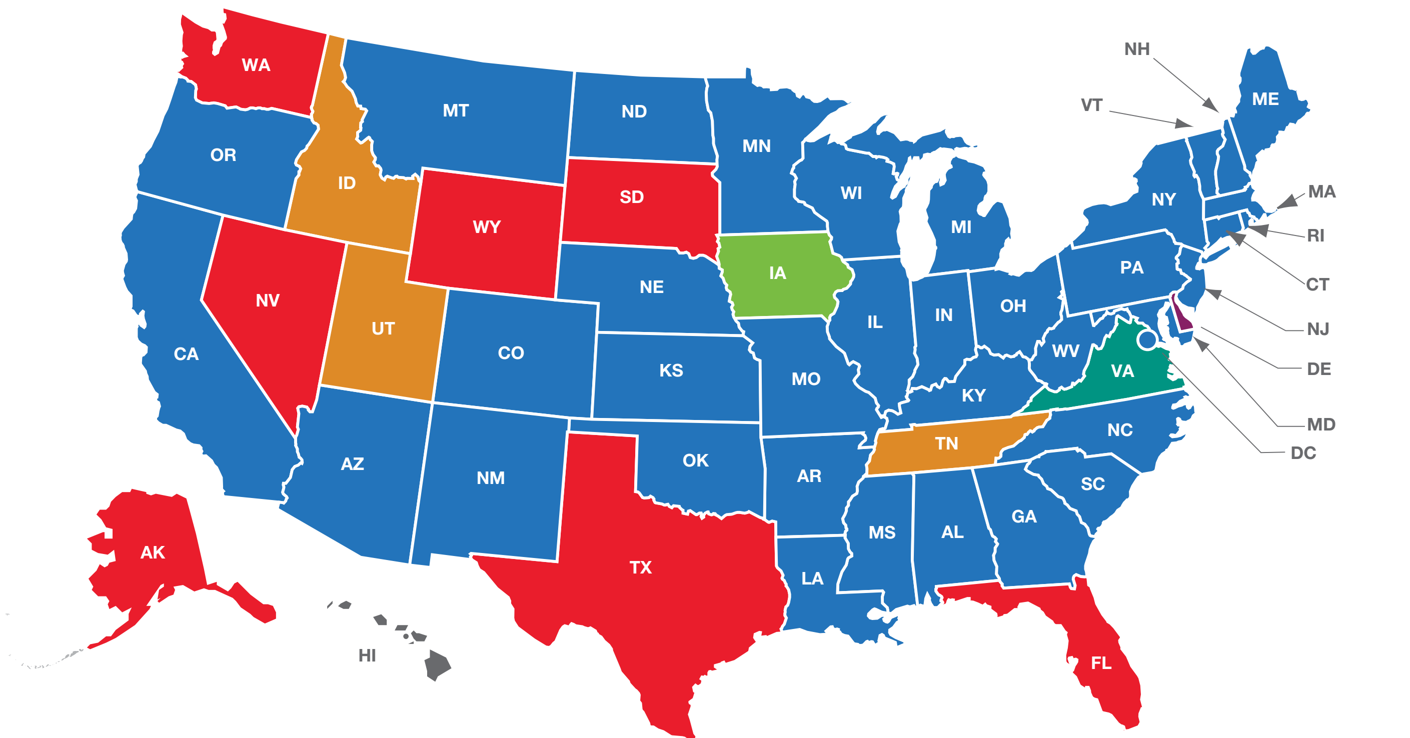
COMMENT. *Paying estimated taxes covers situations in which there might be no income tax withholding or inadequate withholding. Estimated taxes can also be used to cover an individual worker's liability for self-employment taxes, the 3.8% net investment income tax, and the 0.9% additional Medicare tax.*

STATE TAX IMPACT. *Estimated state income tax payments are typically required if an individual worker's expected tax liability for the year exceeds a threshold amount. Some states also permit voluntary estimated tax payments if the designated threshold is not reached (or if estimated tax payments are not required by the state at all).*

In most states, individual workers must make their required estimated tax payments in equal quarterly installments on April 15, June 15, September 15, and January 15. However, many states have also adopted the federal rules that allow farmers and/or fishermen to make a single estimated tax payment,

State Estimated Tax Payment Due Dates (Personal Income Tax)

Individuals must make state estimated tax payments in quarterly installments. Most states adopt the federal due dates (April 15, June 15, September 15, and January 15), but some states vary slightly from the federal dates or do not have due dates (e.g., if estimated tax payments are voluntary).



- April 15, June 15, September 15, and January 15
- April 30, June 15, September 15, and January 15
- April 20, June 20, September 20, and January 20
- April 30, June 30, September 30, and January 31
- May 1, June 15, September 15, and January 15
- No set date (estimated payments are voluntary)
- States with no income tax

Source: CCH Incorporated and its affiliates. All rights reserved.

or completely exempt farmers and/or fishermen from the estimated tax requirements if they file an income tax return and pay the full amount of tax due by a certain date.

In addition, individual workers who do not receive their income evenly throughout the year might be able to calculate the amount of their state estimated tax payments by annualizing their income.

STATE TAX IMPACT. *Individuals should also be aware of their state's income tax filing thresholds. The threshold amount varies widely from state to state, and different filing threshold rules might exist for residents, nonresidents, and part-year residents. Finally, the filing threshold amounts are often adjusted annually for inflation. So, individuals should check the filing thresholds each year to see if their income level triggers a filing requirement.*

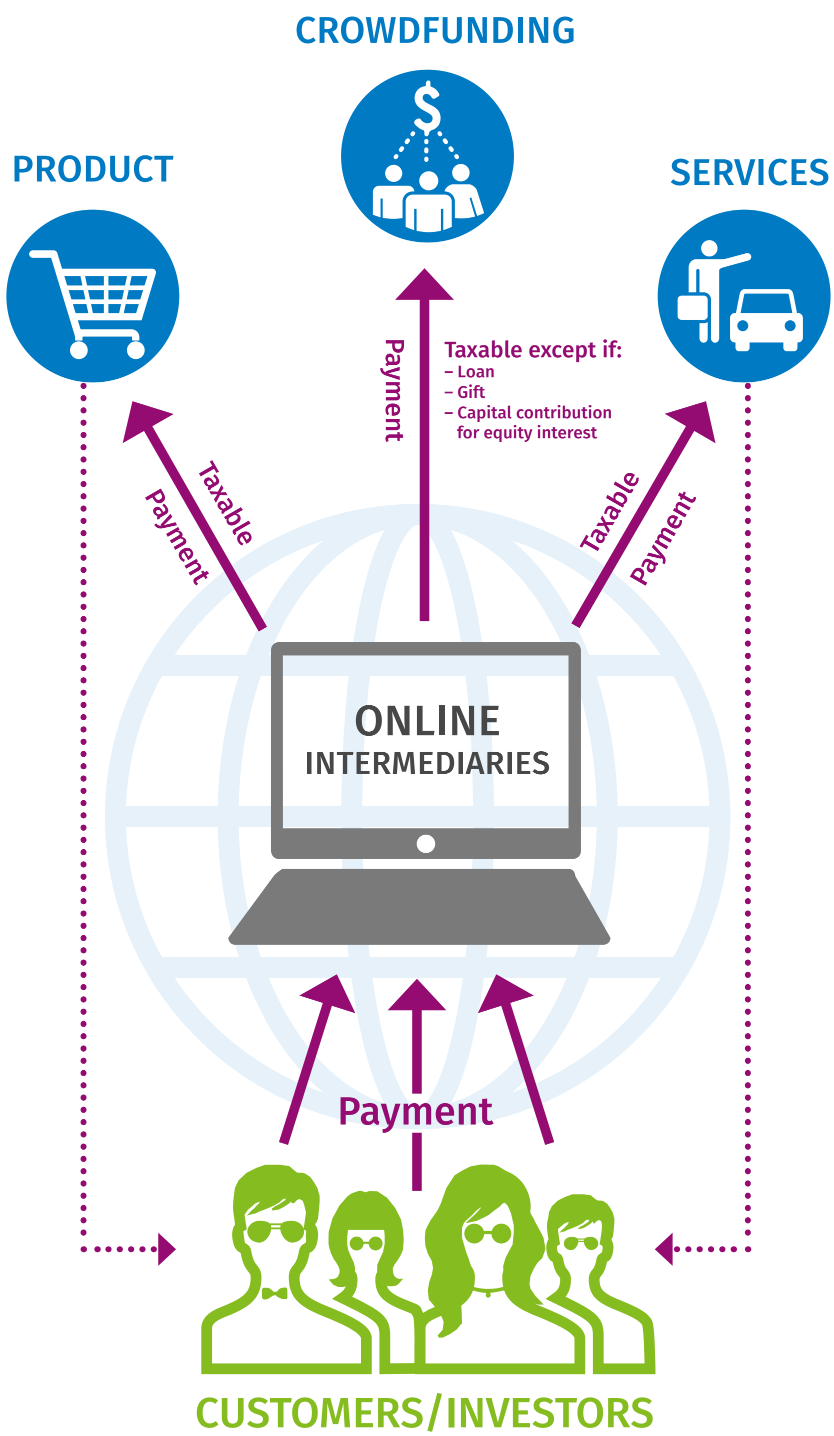
Threshold Requirements

The threshold requirements for individuals to file a federal income tax return are based on gross income, age, filing status, and whether the individual is a dependent. See Table 1 and Table 2 in IRS Pub. 501, Exemptions, Standard Deduction, and Filing Information, for the specific requirements.

1099s

Any payor who pays at least $600 to others during the year, in the course of its trade or business, generally must file Form 1099-MISC, Miscellaneous Income, with the IRS and furnish Form 1099-MISC to the payee. Further, any service recipient engaged in a trade or business must file Form

Sharing Economy – Income Tax Consequences to Participant



Source: CCH Incorporated and its affiliates. All rights reserved.

1099-MISC and furnish it to the payee if, in the course of the trade or business, the service recipient pays remuneration of at least $600 during the year to the payee for services provided by that payee.

> **COMMENT.** *An individual sharing (gig) economy worker may be subject to the Form 1099-MISC filing and furnishing requirements if he or she is the payor of certain types of payments to vendors that provide services to the individual worker in the course of his or her trade or business.*

An individual sharing (gig) economy worker might receive a Form 1099-K, Payment Card and Third Party Network Transactions, from a payor that is required to report certain payments made to the individual in settlement of payment card transactions (e.g., debit, credit or stored-value cards) or third-party network transactions (e.g., PayPal). A payment settlement entity (PSE) making reportable payments to a participating payee in settlement of a reportable payment transaction must file an annual information return with the IRS on Form 1099-K, and furnish a statement to the participating payee. However, for certain *de minimis* payments by a third-party settlement organization, no reporting is required unless the payments to a participating payee exceed $20,000 (monetary threshold) and exceed 200 transactions (transactional threshold) within the calendar year.

> **STATE TAX IMPACT.** *Many states have information return requirements that are similar to the federal requirements, although the threshold amount triggering a state reporting requirement may be different than the federal threshold amount ($600). The due date for reporting the nonemployee compensation to the designated state tax agency may also be different than the date Form 1099-MISC must be submitted to the IRS under federal law (January 31).*

AVAILABLE DEDUCTIONS

Individuals working in the sharing (gig) economy may deduct all ordinary and necessary business expenses related in their trade or business, as long as the expenses are reasonable in amount.

STATE TAX IMPACT. *The federal deductions for ordinary and necessary business expenses are included in federal gross income, federal AGI, and federal taxable income. Since the calculation of state tax liability typically starts with one of these amounts, these federal deductions are usually allowed for state income tax purposes.*

Deductions Specific to Ride Sharing

Individuals who use their automobiles to earn income through ride sharing have two options for deducting expenses. An individual may use the actual cost method and deduct all costs related to operating a vehicle. To deduct these expenses, individuals must substantiate car expenses by keeping an exact record of the amount paid for gasoline, insurance, and other costs. In lieu of calculating the operating and fixed costs allocable to business purposes, individuals may use the standard mileage rate method. Under this method, individuals may deduct a fixed amount for all substantiated miles driven for business purposes (53.5 cents per mile in 2017).

Deductions Specific to Home Sharing

An individual who rents out his or her home (or a portion of the home) may be able to deduct rental expenses. If the individual has a net profit from the rental activity (that is, if rental income exceeds all deductions, including depreciation), the individual deducts all of the rental expenses. Expenses must be allocated between rental and nonrental days and, if only a portion of the home is rented, between the rental and nonrental portions.

COMMENT. *These allocation rules apply to rental activities if the individual uses the unit for personal purposes for even one day during the year, even if the individual's personal use is not enough to qualify the unit as the individual's residence.*

Home Office

Some home-related expenses may be deductible business expenses if they are allocable to the individual's home office. There are two methods for calculating the home office deduction: the simplified method and the actual-expenses method. Under the simplified method, the taxpayer simply deducts $5.00 for each square foot of the home office, up to a maximum of 300 square feet. Thus, the home office deduction under the simplified method cannot exceed $1,500. Under the actual-expenses method, expenses must be allocated between the home office and the remainder of the home, based on the business percentage. That is, the percentage of the home that is used for the home office.

"What is the kiddie tax amount for 2016 and 2017?"

Search Less, **Do More**™

See for yourself: **CCHAnswerConnect.com/KiddieTax**

Wolters Kluwer
When you have to be right

CCH® Answer*Connect*